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3 November 1955



Copy No. **100**

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CURRENT INTELLIGENCE BULLETIN

DOCUMENT NO. 54
NO CHANGE IN CLASS. ☒
[] DECLASSIFIED
CLASS. CHANGED TO: TS S C
NEXT REVIEW DATE: 2010
AUTH: HR 70-2
DATE: 10 JAN 1980 REVIEWER: 

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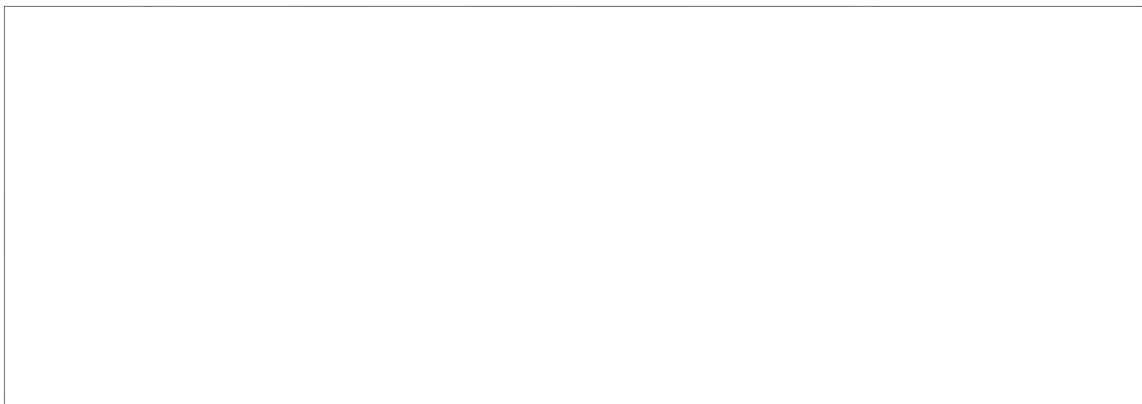
State Dept. review completed

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PACOM Review
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DIA review
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1. ISRAEL'S NEW GOVERNMENT

Comment on:

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David Ben-Gurion's return as prime minister and defense minister in the new Israeli cabinet assures that Tel Aviv will continue its tough border policy and its intensified diplomatic attempts to meet the Arab threat. Ben-Gurion has been labeled an "activist" because of his espousal of firm retaliation on Israel's frontier. He is also Israel's ablest diplomat and most experienced negotiator. His first public pronouncement on resuming control included a warning that Israel will continue to defend itself and an invitation to Nasr and the Arabs to meet at the conference table--which they will automatically reject.

His five-party coalition cabinet, which may be characterized as slightly left of center, controls 75 of the 120 seats in parliament. In the present mood in Israel, which is emphasizing readiness for war and a closing of ranks, Ben-Gurion's decisions in terms of the war crisis will receive full public and parliamentary support.

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2. ISRAEL SEEKING MILITARY EQUIPMENT FROM ITALY

Israel wishes to purchase a large order of planes and military equipment in Italy, according to the American embassy in Rome.

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the desired equipment included 40 F-51's, 50 Sherman tanks, 50 M-7 self-propelled guns, 120 armored cars, 500 bazookas, and as many Browning machine guns as are available.

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Comment

These prospective arms purchases would be in line with Israel's stated policy of seeking arms from any source, preferably from the West. In late October the Israeli cabinet in a special session voted to spend \$50,000,000 for arms. Earlier reports indicate that Israel may also be negotiating for two destroyers from Italy.

Italy would probably be willing to sell this equipment to Israel in line with the Segni government's desire to play a larger role in Middle East affairs.

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4. SOUTH KOREA FACING SERIOUS INFLATION PROBLEM

Comment on:

South Korea is again threatened with inflation that could result in a serious weakening of the currency and a resumption of bitter attacks on the United States as responsible, according to Economic Co-ordinator Wood in Seoul. He anticipates a price rise of at least 80 percent, and possibly as high as 140 percent, during the fiscal year ending next July.

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Wood expects that the money supply will be increased by 80 percent during the year, primarily in order to cover a budget deficit of about \$125,000,000. Inflation to this degree would undermine the effectiveness of the American aid program by discouraging the development of local industry and exports and by encouraging black markets, speculation and corruption. It would also require an upward revision of the hwan-dollar exchange rate next September, with a renewal of the acrimony which has characterized this issue.

The attainment of a balanced budget will be difficult as long as South Korea maintains its present large military establishment. This year's national defense allocation of \$165,000,000 just about equals the government's entire anticipated revenues. The basic weakness of the South Korean economy, which suggests the need for substantial foreign aid for years to come, is indicated by the estimated import requirements for the next two years of \$842,000,000, against exports of only \$70,000,000.

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BIWEEKLY SUMMARY
20 October-2 November 1955

THE FORMOSA STRAITS

**Report of the IAC Current Intelligence Group
for the Formosa Straits Problem**

1. There were no major military developments. Shelling by both sides continued in the Quemoy, where the Chinese Communists fired about 250 rounds, most of these on 26 October. Nationalist artillery fired over 1100 rounds against the Communists that day, which may have turned routine harassment fire, initiated by the Communists, into an artillery duel.

The first Chinese Nationalist operation in the past month against Communist naval vessels was reported on 30 October. Four Nationalist aircraft attacked two patrol craft 25 miles northeast of Matsu, and one of the vessels was reported to have been left burning. Poor weather has restricted naval activity by both sides during the past several weeks.

2. A MAAG-sponsored plan for the rotation of Chinese Nationalist units on the offshore islands with units recently trained on Formosa is under way. So far only one artillery battalion on Quemoy has been rotated to Formosa, but the plan envisages the eventual rotation of every unit. These rotations will not only provide needed training on Formosa for the units which have been garrisoning the offshore islands for some time, but will also ensure that the offshore islands are eventually defended by units which have had recent intensified training under MAAG supervision.

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The Chinese Communists have consistently asserted that Peiping is willing to "liberate" Formosa by "peaceful means" but have not renounced military action if "peaceful means" fail.

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4. Peiping propaganda output on the subject of Formosa during the past two weeks (18 October - 1 November) showed an increase in volume, with renewed emphasis on the theme of "peaceful liberation" through negotiations with "local authorities;" a theme not stressed since early September.

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